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RUEHQT/AMEMBASSY QUITO 2259
RUEHSG/AMEMBASSY SANTIAGO 3628
RUEHGL/AMCONSUL GUAYAQUIL 0540
RUCPDOC/DEPT OF COMMERCE
RHEBAAA/DEPT OF ENERGY
RUEATRS/DEPT OF TREASURY
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C O N F I D E N T I A L CARACAS 002067

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NSC FOR DTOMLINSON
HQ SOUTHCOM ALSO FOR POLAD
TREASURY FOR KLINGENSMITH AND NGRANT
ENERGY FOR CDAY, DPUMHREY AND ALOCKWOOD
COMMERCE FOR 4431/MAC/WH/MCAMERON

E.O. 12958: DECL: 07/07/2026
TAGS: EFIN PGOV VE
SUBJECT: BRV PUBLIC CREDIT CHIEF'S VIEWS ON DEBT MANAGEMENT
AND NEW BOND ISSUES

REF: A. CARACAS 00632

¶B. CARACAS 00943
¶C. CARACAS 00659
¶D. CARACAS 01739
¶E. CARACAS 01426
¶F. CARACAS 00512

Classified By: Economic Counselor Andrew N. Bowen for Reason 1.4 (D).

SUMMARY

¶1. (C) On July 6, econoffs met with Public Credit Chief Rudolf Romer to discuss the BRV's debt management strategy and upcoming bond issues, including the recently announced joint Venezuelan-Argentine "Bonds of the South." Noting Venezuela's debt profile had improved significantly in recent years, Romer expected a USD 3 billion net decrease in debt stock in 2006, bringing total debt stock to USD 42-43 billion (25-27 percent of GDP). He also said Venezuela would issue an additional USD 3.1 billion in debt in 2006. Romer said he had recommended that any potential joint Venezuelan-Argentine bond issue not be structured to allow cross-default, whereby each country assumed the risk of the other. Instead, each country would issue bonds, with separated risks, that would be sold jointly. Romer understood that PDVSA would likely issue dollar-denominated bonds locally (USD 3.5 billion according to press), with 15-20 years maturities, but could not confirm the details because PDVSA had independent authority to issue bonds. To minimize Venezuela's future vulnerability to sharp decreases in oil prices, he said that the BRV planned to use tax revenue to fund all ordinary expenses; and to use oil revenue to cover debt service, investment, and savings. End Summary.

DEBT MANAGEMENT STRATEGY

¶2. (C) Romer, Chief of the Ministry of Finance's National Office of Public Credit, said that BRV debt management had two goals: (1) to reduce the debt load (both as a percentage of GDP and the overall debt stock) and (2) to improve the debt's maturity profile (reftel A). Romer said that last year, the BRV reduced debt as a percentage of GDP, but that debt stock had grown slightly. (Note: From 2004 to 2005, BRV debt increased by USD 3.9 billion, reaching USD 46.7 billion at end of 2005. End Note.) For 2006, Romer anticipated a USD 3 billion net decrease in debt stock, reducing total debt stock to USD 42-43 billion. He added that debt as a percentage of GDP could be 25-27 percent, depending on the GDP figure. Romer noted that the BRV had a significant concentration of payments (both capital and interest) due in 2006-2008 that it was refinancing to stretch out until 2020. Starting in 2009, Romer said that debt service payments would not exceed USD 5 billion annually, as compared to the USD 9 billion in debt service paid annually in prior years. Romer noted that Venezuela's debt management profile, "which had been a very serious issue", had improved significantly. According to an internal chart Romer showed econoffs, debt as a percentage of GDP was 84.8 percent in 1988, 69 percent of GDP in 1995, and they were planning to achieve a ratio of 24 percent in 2007 and 20 percent by 2008.

¶3. (C) Romer said that Venezuela would issue an additional USD 3.1 billion in debt this year which could be issued domestically or overseas. He boasted that Venezuela had developed a long-term domestic market, which would allow it to finance domestic debt until 2011 or 2015. In 2006, the BRV had already completed its re-purchase of Brady bonds. (Note: In March 2006, the Finance Minister announced that Venezuela would repurchase USD 3.9 billion in Brady Bonds as part of the BRV's strategy to reduce overall debt. The Venezuelan government issued these bonds as part of the 1990 debt refinancing. End Note.) The BRV's 2006 national budget requested, and Romer said that he had authorization, to issue USD 7.3 billion in debt this year; however, Romer said that the BRV would only borrow what it needed.

THE "OTHER BUDGET"

¶4. (C) Acknowledging that BRV budgeting was "perhaps a little creative," Romer described the relationship between the national budget, debt financing, and the "other budget." According to Romer, both oil revenue and tax revenue are underestimated in the budget process (oil revenue was calculated using a USD 26 per barrel assumption, while current reality is closer to USD 57), creating a deficit that must be financed with debt. Romer said that Venezuela had learned from prior experience to budget conservatively to avoid unexpected oil revenue shortfalls. According to Romer, the excess income goes to the National Treasury or the National Development Fund (FONDEN) (reftel B), which together (along with other funds) make up the "other budget," which Romer said was for investment. The BRV uses its funds from the "other budget," instead of debt financing, for the same projects contained in the national budget. According to Romer, the BRV is using approximately USD 5 billion in excess income from last year to fund all of the additional credits requested from the National Assembly this year. (Note: As of June 27, the National Assembly had approved additional credits of USD 9.1 billion. Presumably, excess revenues generated this year, or allocated but unspent budgetary funds, will cover this gap. End Note.)

¶5. (C) According to Romer, to minimize Venezuela's vulnerability to sharp decreases in oil prices, the BRV plans to use tax revenue to fund all ordinary expenses; and to use oil revenue to pay for debt service (estimated at USD 5 billion annually starting in 2009), investment, and savings. Romer described FONDEN as a mechanism for the BRV to save excess oil revenue, without affecting the monetary base. (Note: Because FONDEN's foreign currency holdings are not

included as part of Venezuela's international reserves, it is not considered part of the monetary base. End Note.)

¶6. (C) With the caveat that he did not have specifics, Romer said that FONDEN had received approximately USD 17 billion to date, of which USD 5 billion already had been spent (USD 2.5 billion for the re-purchase of the Brady Bonds and USD 2.5 billion on infrastructure). By year's end, he said that the BRV plans to spend USD 5 billion more from FONDEN, leaving a balance of approximately USD 13-15 billion after additional deposits made during the remainder of this year. Given the BRV's past experiences of spending roughly USD 3.5 billion a year on investment, Romer was skeptical it had the capacity to spend USD 10 billion from FONDEN. Romer claimed that the BRV currently had more than enough money to fix many of its problems -- but not the capacity. He mentioned, as an example, that the government could close the enormous housing gap but that there wasn't enough raw materials, labor or construction firms capable of doing so. Separately, Romer noted that FONDEN has trust funds in the Treasury Bank, which holds its funds in 9-10 highly rated international banks.

ARGENTINE BONDS

¶7. (C) Romer said that everyone won with the Argentine bond transactions (reftel C). According to Romer, Venezuela has purchased approximately USD 3 billion in Argentine debt to date. After reselling much of the Argentine debt to local banks for resale, Venezuela would most likely have USD 800 million remaining at the end of the year. For Argentina, Venezuela provided financing and helped Argentina to develop a secondary market for its bonds. According to Romer, Argentina said that Venezuela was the largest investment bank in Latin America. For Venezuela, the Argentine bonds provided an alternative to the Central Bank (BCV) certificates of deposit (CDs) and BRV bonds to help control monetary liquidity. Romer said that the BRV sells the bonds about 8-9 points above the market price and that investors earn about 3-4 points in foreign exchange earnings. He said that local/multinational companies invest in Argentine bonds as a hedge while waiting for CADIVI (the FX control authority) to approve their repatriation of dividends.

¶8. (C) Romer could not confirm the amount for a recently announced joint Venezuela-Argentine "BonoSur" or "Bond of the South", but press reports said that the initial issue could be between USD 1-2 billion and take place within the next 60-90 days (or perhaps clarification of the bond's details will take place within that period). Romer said that "no one wants the bonds to cross default," where each country assumes the risk of the other. Instead, each country would issue bonds to be sold jointly, but with separate risks. The price of the "joint bond" would be somewhere between the price of each country's bond. Romer said that the BRV and Argentina were still perfecting the bond issue. He added that this issue could happen this year and that once the mechanism was established, it could possibly be used for other countries, in particular Caribbean nations.

¶9. (C) Romer noted that the idea behind the Banco del Sur (Bank of the South) was to unify under one entity -- with clearer rules and structure -- various activities that Venezuela currently undertakes through separate mechanisms. For example, unifying Venezuelan bond purchases from Argentina, and a smaller amount from Ecuador, with the activities of the BRV-owned Social Development Bank (BANDES) which also has projects abroad. Separately, local media reports that the BRV is considering purchasing bonds from Paraguay and Costa Rica.

PDVSA BONDS

¶10. (C) Romer said that Venezuelan petroleum company (PDVSA) originally sought financing from the Japan Bank for International Cooperation (JBIC) to advance its 5-year USD 20 billion investment plan, but the terms were unattractive, prompting PDVSA to go to the market. Based on his last discussions with PDVSA, Romer understood that PDVSA would likely issue dollar-denominated bonds locally, with 15-20 year maturities, though he could not confirm this because PDVSA had independent authority to issue bonds. Press reports indicated that PDVSA could issue USD 3.5 billion in debt. According to Romer, in order to issue bonds, PDVSA needed to have audited 2005 financial statements, which will most likely be available in mid-August. Romer said that the PDVSA debt issue would contribute to reduce the amount of BCV-issued CDs (used to mop up liquidity), allowing the BCV to have a more comfortable debt load. (Note: Money supply (M2), which equals currency, checking accounts, savings deposits, and CDs, has grown 61 percent since June 2005, reaching USD 38.5 billion in June 2006, causing significant financial strain for the BCV (reftels C-E) End Note.)

COMMENT

¶11. (C/NF) Romer is the most open, pragmatic and straight-forward senior BRV financial official that econoffs have met. He said he was 43 years old and appeared to econoffs to be US educated (though we have not confirmed this). He also professed a great affinity for the United States. The fact that he has been placed in this critical and sensitive position -- as one of the BRV's senior money managers -- clearly speaks to the confidence that Minister Merentes (whom he worked previously for at the National Development Bank (BANDES)) and, most likely others in the BRV, have in him.

BROWNFIELD